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Even if the government can prove knowledge, it is unlikely that merely creating a product that is then used in illegal activities would be sufficient to show participation. A defendant can aid and abet a crime by failing to take an action only if that failure was "with the specific intent to fail to do something the law requires to be done."⁹² Moreover, for aiding and abetting liability to be based on failure to act, there must be "a legal duty and not simply a moral duty." Founders and Company, by staying removed from illegal activities, advising against the use of Ripple Credits for illegal activities, and educating the public about their lack of involvement in and control over third party transactions, will significantly reduce their risk of aiding and abetting illegal activity.

9. Tax Evasion

It is a felony to "willfully attempt in any manner to evade or defeat any tax" imposed by the Internal Revenue Service.⁹³ Furthermore, persons who conspire to "commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose," are subject to fines and imprisonment.⁹⁴ While Founders and Company may not have income tax exposure arising from the distribution of Ripple Credits, merchants, online retailers, and others who accept Ripple Credits in lieu of payments in USD or currencies of other countries will be responsible for reporting the income tax associated with such receipts. Bartering income is taxed at the fair market value of the goods and services exchanged, which would suggest that a merchant accepting Ripple Credits for a good is responsible to pay income taxes on the fair market value of the Ripple Credits, which is equal to the fair market value of the good exchanged for the Ripple Credits.⁹⁵ Founders and Company should make clear to Ripple Network participants that they will be responsible for tax liability associated with the acceptance of Ripple Credits.

In addition to federal income tax, people buying, selling and exchanging Ripple Credits will be responsible for state income tax and sales tax liability associated with such Ripple Credits. While state laws vary significantly, state income tax liability associated with the receipt of Ripple Credits in a given year will be calculated, in most states, similarly to the federal income tax calculation. For state sales tax purposes, the Streamlined Sales and Use Tax Agreement defines "Sales price" as "the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise..."⁹⁶ This agreement has only been adopted by some states, and even in states where it has been adopted the definition of "sales price" may not be uniform.

Similarly, although Founders and Company may not have income or sales tax exposure arising from transactions involving Third Party Ripple Currencies, participants may be responsible for sales, income and gross receipts taxes. It seems likely that most state and local governments

⁹² *Bailey*, 405 F.3d at 110 n. 4 (approving language from jury instruction).

⁹³ 26 U.S.C. § 7201.

⁹⁴ 18 U.S.C. § 371.

⁹⁵ Internal Revenue Service, *Bartering Income* (July 11, 2011), available at <http://www.irs.gov/businesses/small/article/0,,id=187904,00.html>.

⁹⁶ Streamlined Sales and Use Tax Agreement, 136 (May 19, 2011).

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would treat Original Ripple System promises to pay similarly to the way they would treat electronic currency, stored value, or conventional debts. The recognition and transfer of Third Party Ripple Currencies promises to pay should not themselves create a transfer tax liability; however, to the extent Third Party Ripple Currencies promises to pay are made in conjunction with a transfer of taxable goods or services, a transfer tax liability would arise. At least two caveats apply to this general conclusion. First, if the Third Party Ripple Currencies promise is denominated in a good or services that is subject to sales and use tax (e.g., one hour of carpentry service or an iPhone 5) the settling of Ripple promises could create additional taxable events. Second, there can be casual sale or other state exemptions which reduce the transfer tax burden for individuals who are not engaged in business. Ripple's Frequently Asked Questions section states that transactions "between private parties" are "normally NOT taxable" in contrast to a sale between a business and private person.⁹⁷ While this is true insofar as many states have casual or occasional sale exemptions that eliminate sales and use tax obligations on individuals making an occasional sale (e.g. a garage sale), most states will define an individual as a retailer and require collection if the individual makes a certain number of sales (generally, three per year) or holds herself out as making sales. Thus, even if a user is a private individual, he or she is likely subject to sales tax collection responsibilities if he or she denominates his or her Third Party Ripple Currencies promises in a taxable good or service or sell those goods or services in more than a few transactions each year.

In addition to sales tax issues, participants may run into issues with income and gross receipts taxes. In the extreme example, individuals could speculate or invest in Third Party Ripple Currencies promises. For example, buy a Third Party Ripple Currencies promise to pay an ounce of gold in exchange for a promise to pay USD \$800 and resell that promise to pay an ounce of gold for a promise to pay USD \$850 (a gain of USD \$50, assuming the creditworthiness of the promises). Likewise, a promise to pay by a less creditworthy participant might sell for a discount compared to a promise to pay by someone with good credit. All such transactions in intangibles can give rise to income and gross receipts tax to those engaging in the exchanges and transactions.

In light of the foregoing, although Founders and Company are not subject to tax liability directly from the transactions occurring in the Ripple Network, Company should advise users of Ripple Credits to evaluate sales tax obligations related to accepting Ripple Credits and engaging in transactions involving Third Party Ripple Currencies just as such users would evaluate sales tax for transactions involving money.

10. Other Considerations

There are a number of other legal and non-legal issues that Founders and Company should consider when forming the Opencoin product and structure, including the following:

- a. **Foreign Regulation.** While this memorandum discusses United States regulation, Founders and Company should consider the risks of violating similar laws in all nations in which Ripple Credits are promoted, sold, and exchanged.

⁹⁷ "Is Ripple Taxable?," available at http://ripple-project.org/Main/FAQ#Is_Ripple_taxable.

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For instance, Founders should consult with European counsel to determine whether Ripple Credits will be considered e-money and therefore regulated and requiring registration under the Electronic Money Institutions Directive ("E-Money Directive"). The E-Money Directive defines electronic money as "electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions...and which is accepted by a natural or legal person other than the electronic money issuer."⁹⁸ The risk of regulation likely is low because the value of Ripple Credits will be based on the Opencoin economy but not backed by Founders or Company, and therefore there will be no claim on the issuer. However, the risk should not be completely ignored because there are commentators who believe that crypto virtual currency, such as Opencoin, would be subject to the E-Money Directive.⁹⁹

- b. Hackers/security.** Founders and Company should consider risks associated with security breaches or hackers breaking into the Ripple Network, like what occurred with Bitcoin and Mt. Gox. While Founders and Company themselves may not have specific disclosure obligations arising from a breach resulting in a release of personal information, exchanges and other third party participants who aggregate and store Ripple Credits on behalf of individuals may face risk.
- c. Promotional Ripple Credits and Expiration.** To the extent that Ripple Credits are considered prepaid access, Founders can issue unpaid, promotional Ripple Credits, which could expire, provided that proper disclosure is made. To the extent that Ripple Credits are considered prepaid access, they may also be regulated by the Federal CARD Act as a "general-use prepaid card," which is "a card, code or other device that is (i) issued on a prepaid basis primarily for personal, family, or household purposes to a consumer in a specified amount, whether or not that amount may be increased or reloaded, in exchange for payment; and (ii) redeemable upon presentation at multiple, unaffiliated merchants for goods or services, or usable at automated teller machines."¹⁰⁰ If Ripple Credits are general-use prepaid cards, then there will be limitations on expiring or imposing fees. However, Ripple Credits that are issued in connection with loyalty, award or promotional programs may expire provided that the expiration date is stated on the front of the card and it is indicated on the front of the card that it is issued for a promotional, award or loyalty purpose.¹⁰¹ Because Ripple Credits will not be issued in the form of a card, disclosure would need to be in a comparable location on the user interface that the holders of Ripple Credits view. Additionally, many state gift certificate statutes require issuers of

⁹⁸ Directive 2009/110/EC, *Second Electronic Money Directive*, Tit. I, Art. 2, § 3 (2009).

⁹⁹ See, e.g., Edwin Jacobs, *Bitcoin: A Bit Too Far?*, Journal of Internet Banking and Commerce, vol. 16, no. 2 (August 2011).

¹⁰⁰ 12 C.F.R. § 205.20(a)(3).

¹⁰¹ 12 C.F.R. § 205.20(a)(4).

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promotional gift certificates or cards to indicate the expiration date on the front of the gift certificate or card, in capital letters, and in at least 10 point font.¹⁰²

d. **Employee Payment/Wage & Hour.** Founders and Company will need to compensate the dedicated team of developers and business people in compliance with wage and hour requirements. Founders have indicated that Company will employ a dedicated team of developers and business people who support the Ripple Network. Founders and Company will need to consider how this team will be compensated. Having a volunteer team or compensating the team with Ripple Credits will both likely result in the violation of state wage and hour laws. These laws generally require employers to pay non-exempt employees minimum amounts for hours worked, and these amounts can not generally be paid in anything other than legal tender of the United States or something readily convertible thereto.¹⁰³

¹⁰² See, e.g., Cal. Civ. Code Civ. § 1749.5(d) (explaining that consumer protection laws do not apply to gift certificates distributed pursuant to an award, loyalty, or promotional program without any money or thing of value being exchanged if the expiration dates are printed on the face, in capital letters, in at least 10 point font).

¹⁰³ See e.g., RCW 49.46.010(2).

Investor Presentation October 2012



Summary

- Ripple aims to become the next PayPal providing:
 - Free payments to merchants and consumers
 - Ability to pay in any currency - traditional or virtual
 - Global payments without providing any personal data
 - Elimination of charge-back risk to merchants
- The platform creates an embedded currency - Ripple Credits
 - Each new user receives a large number of free Credits
 - Credits are initially used in lieu of transaction fees to prevent system attacks
 - Because of their clear advantages, Ripple Credits should become a popular payment method over time
- Ripple's business model is based on Credits gaining acceptance and value. BitCoin, an open source payments and currency platform, has proven the viability of this approach.



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The Need for a Better Payments Platform

- Payments processing costs business and consumers over \$50 Billion per year
 - PayPal charges up to 2.9% of each payment
 - Most new payment companies are built on the same expensive payments infrastructure
- For merchants, charge backs create additional cost and uncertainty
 - Particularly high for online purchases and services
- Restrictions, approvals and account suspensions add further inconvenience
 - PayPal has angered many merchants with arbitrary account suspensions
 - Cross border payments are very complex
 - The unbanked have difficulty securing any payment option

The world needs an alternative payments platform built fundamentally on the advantages of a networked world



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The Need for a Better Distributed Payments Platform

- BitCoin was the world's first distributed payments platform to gain wide acceptance
 - BitCoin is both a currency **and** a distributed open source payments platform.
 - BitCoin provides free, global payments without charge backs using a new virtual currency. It's been surprisingly successful given it was started as an anonymous project.
- Despite its early success, BitCoin has major flaws that restrict adoption
 - Confusing process to acquire and use BitCoin
 - The system relies on complex private keys (e.g. 1CC3X2gu58d6wXUWMffpuzN9JAFTUWu4Kj). Securing and remembering accounts is very user-unfriendly.
 - Merchant roadblocks
 - Because payments can only be accepted in BitCoins, merchants must commit to a radical new virtual currency they likely don't understand or trust.
 - Accepting BitCoins means either incurring currency risk (i.e. keeping BitCoins) or exchange fees
 - Scalability and security issues
 - BitCoin is slow - transactions take 10 to 60 minutes to verify; hours for the client to download
 - A single attacker gaining over 50% of the network's computing power can take over the system

Despite its flaws, BitCoin proves that a distributed payments platform is viable. A system that fixes these flaws and is actively promoted should become hugely popular.



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The Ripple Solution

- Using BitCoin's distributed approach, Ripple is radically superior to PayPal
 - Payments are free to both consumers and merchants
 - No charge-back risk to merchants
 - Payments are accessible to everyone, *globally* from day one
 - Open source allows third parties to build custom features, like reversibility, where needed
- Ripple improves dramatically on BitCoin's implementation
 - *Easy*: use nicknames to send and receive money
 - *Fast*: transactions clear within 5 seconds, the client downloads in seconds
 - *Secure*: not vulnerable to a single attacker
 - *Multi-currency*: transact in the currencies you use today, no need to adopt a new virtual currency
- Ripple focuses first on being a better payment platform, second as a new currency
 - While virtual currencies are interesting conceptually, merchants and consumers need low cost, easy to use payments options
 - Payments volume supports the new currency. As the platform scales, Ripple Credits are positioned to be the successor to BitCoins

Ripple combines the best of PayPal and BitCoin



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Comparing Payment Platforms

	<i>Problem</i>	<i>Ripple Solution</i>
PayPal	<ul style="list-style-type: none"> <input type="checkbox"/> High merchant costs – 2 to 3% <input type="checkbox"/> Charge back risk to merchants <input type="checkbox"/> Account restrictions <input type="checkbox"/> Global limitations <input type="checkbox"/> Prohibitive micro-payment fees 	<ul style="list-style-type: none"> <input type="checkbox"/> Free, unrestricted, global and irreversible payments enabled by zero cost distributed platform <input type="checkbox"/> Frictionless, ideal for micro-payments
BitCoin	<ul style="list-style-type: none"> <input type="checkbox"/> Difficult to understand accounts (e.g 1CC3X2gu58d6wXUWMffpuzN9JAfTUWu4Kj) <input type="checkbox"/> Difficult to acquire (mining process, long initial downloads) <input type="checkbox"/> Slow 10+ minute confirmations <input type="checkbox"/> Security issues – safeguarding money is non-trivial. Attack vulnerability <input type="checkbox"/> Requires adoption of a weird new currency 	<ul style="list-style-type: none"> <input type="checkbox"/> Easy to use nicknames, passphrases and Facebook account names <input type="checkbox"/> Accounts and Ripple Credits given away free. Client downloads in seconds. <input type="checkbox"/> 5 second confirmations <input type="checkbox"/> Built-in wallet for safekeeping. Eliminates attack vulnerability. <input type="checkbox"/> Pay in any currency. No need to think about virtual currencies.

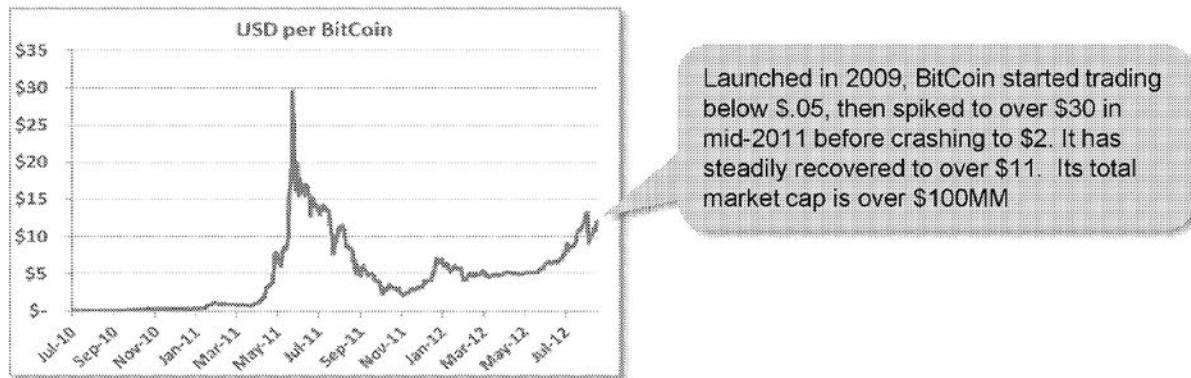


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The Business Model

Adoption of Ripple Credits

- Ripple's business model is based on the success of Ripple Credits
 - The Company will keep between 25% to 30% of all Credits created
 - The Company will sell these Credits to exchanges over time to fund operations and return capital to investors
- Can a virtual currency really create and hold value? *BitCoin proves it can.*



By improving on the lessons of BitCoin, Ripple Credits should be even more valued

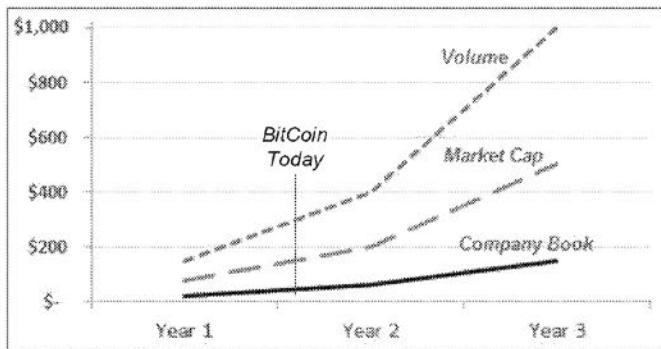


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The Business Model

Why Ripple Credits Should Succeed

- Demand for BitCoins derives from:
 1. **Speculation:** limited supply that can never change (21MM units max)
 2. **Store of value:** trust in the cryptography over time (3 years)
 3. **Payments:** steady adoption by merchants and consumers (approximately 500K)
- Ripple Credits should be more successful than BitCoin
 - Fixing BitCoin's merchant adoption issues, payments demand should be much stronger and become the key driver of value
 - Improved cryptography should support store of value demand
 - Limited supply just like BitCoin



Assumptions

- Total annual transaction **volume** assumes average user transacts \$500 per year
- **Market Cap** is the total value of all Ripple Credits, calculated at 50% of volume**
- **Company Book** is the company's share of Credits assuming it keeps 30% of total

** Ratio of BitCoin volume to market cap is 2 to 1. Ratio of US GDP to M2 is 1.8 to 1.



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Founders and Team

Chris Larsen, CEO and co-founder

- CEO and co-founder, Prosper.com, 2004 to 2012: peer-to-peer lending marketplace
- CEO and co-founder, E-LOAN, 1992 to 2004: publicly traded online lender
- Stanford MBA, 1991

Jed McCaleb, CTO and co-founder

- CTO and founder, MetaMachine, 1999 to 2005: creator of the eDonkey file sharing application, one of the world's largest at the time
- CEO and founder, Mt.Gox, 2010 to 2011: largest BitCoin exchange with 80% market share, sold in 2011 to start this venture

Arthur Britto, Developer and co-founder

- Created one of the first ISP's and one of the first BitCoin exchanges

David Schwartz, Developer and Cryptographer

- Chief Technical Officer, WebMaster Incorporated, 2001-2011, cloud based software
- Worked with NSA on cryptography



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Regulatory and Legal

- Retained Perkins Coie to advise on regulatory issues
 - Dax Hansen, Partner in charge of Electronic Financial Services practice with expertise in electronic payments and virtual currencies
- Mitigating regulatory risks
 - Ripple does not maintain the payments system on its servers. The product is a distributed open source platform that is not centrally controlled.
 - Ripple will position the distributed design of the platform as entirely about cost reduction to consumers and merchants.
 - Ripple will actively engage with law enforcement and only promote legal and constructive uses of the platform.
 - BitCoin has operated for 3 years without much regulatory concern
 - Some Governments, such as Finland, have began to embrace BitCoin
 - The FBI issued an extensive report on BitCoin that was fairly neutral



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Marketing Strategy

- Phase 1: Early Adopters – *at soft launch*
 - BitCoin users and merchants
 - Virtual goods purchases
 - Android In-app purchases
- Phase 2: Early Majority – *one year from soft launch*
 - International transfers
 - Mainstream merchants
- Phase 3: Late Majority – *three years from hard launch*
 - Large retailers
 - Amazon, Wal*mart



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Phase 1 Marketing: BitCoin Community

Market Attributes

- Approximately 500K users, 1000's of merchants
- Strong supporters of virtual currencies and financial innovation
- Need an easier way to pay with BitCoins, will appreciate that the platform enables this
- Will understand Ripple Credits as a new and improved version of BitCoin currency
- Growing 3rd party developer community that we have early indications will welcome Ripple and Ripple Credits (e.g. BitInstant, BitPay, Coinworker, Coinabul)

Keys to success

- Incent these users to support Ripple by giving them a special allocation of free Credits
- Show 3rd party developers that building apps for both BitCoin and Ripple is complementary and a win-win
- Emphasize usage of platform as a better way to use BitCoins
- Use team's deep connections to the BitCoin community



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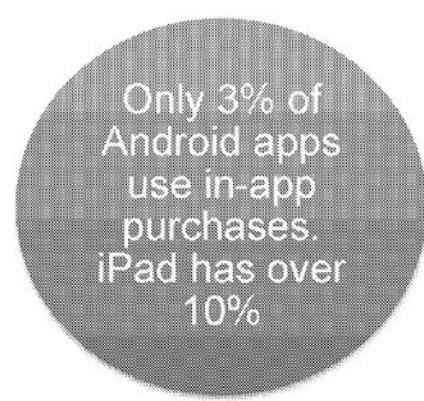
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Phase 1 Marketing: Online Gaming and Virtual Goods

Android in-app purchases

- All top selling online games have In-App purchases
- In-App purchase penetration is very low on Android
- Google Play cost developers 30% of revenue
- Android is open to services like Ripple (iOS isn't)



Virtual goods resellers

- Larger virtual goods resellers make over \$100K per day
- Existing options like PayPal are very expensive for the typically small items sold (often averaging \$1 or less).
- Charge back risks are very high
- Young and unbanked gamers don't have access to PayPal or credit cards



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Phase 2 Marketing: Mainstream Merchants and International Payments

Mainstream Merchants

- All are concerned with fees
- Services and media sellers very concerned about charge backs
- Many will need to offer charge back protection to consumers, particularly for large items

International Transactions

- High fees - \$45 bank to bank, 3% foreign debit card fees
- Very restrictive depending on the country

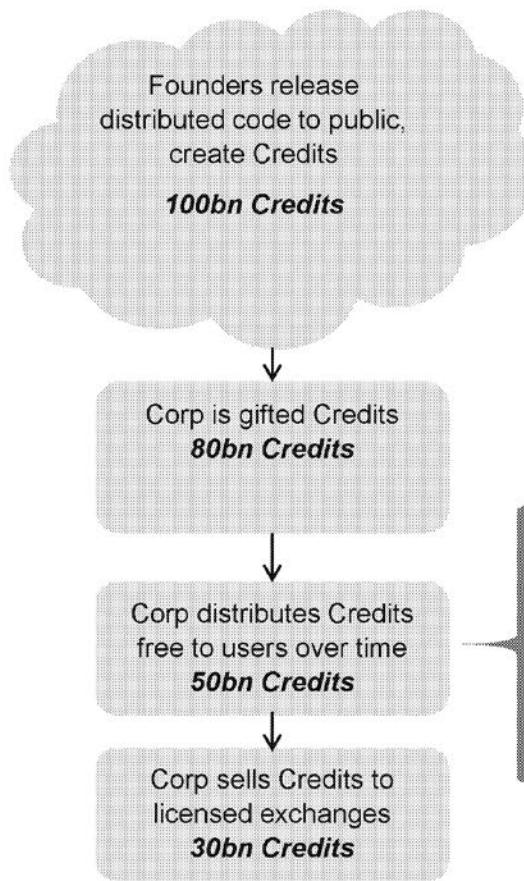
Key to success

- Position as a free payments system – virtual currency doesn't need to be considered
- Build client apps that are extremely easy to use
- Encourage and promote 3rd party companies and apps that enable charge back protection where needed



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Distribution of Credits Over Time



- At launch, a large portion of Credits will be distributed to BitCoin users to encourage their early support and adoption
- Consumers will receive a large amount of free Credits when they create their accounts
- As the price of Credits increases and less are needed to prevent attacks, free Credits per user will drop accordingly
- In total, about 50bn Credits (half of all) will be given away free, the rest will be sold to exchanges

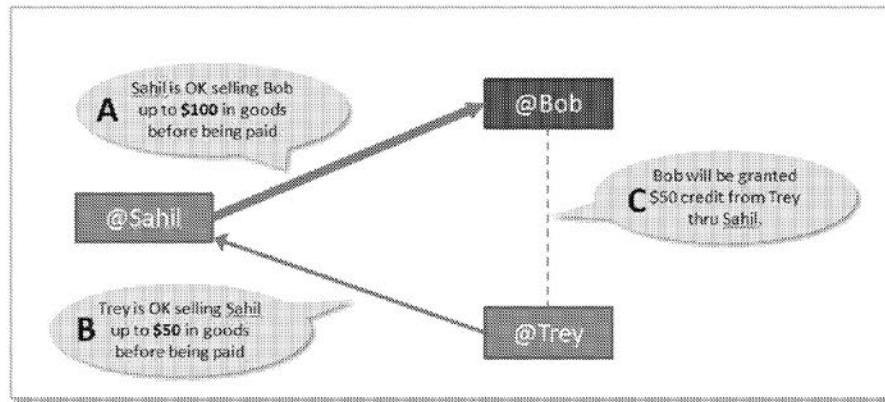
Time Period	User Target	Given per user	Total Users	Total Given
Launch	BitCoin Community	500K	60k	3bn
Year 1	Facebook Users	10,000	1mm	10bn
Year 2	Facebook Users	1,500	10mm	15bn
Year 3	Facebook Users	150	150mm	22bn



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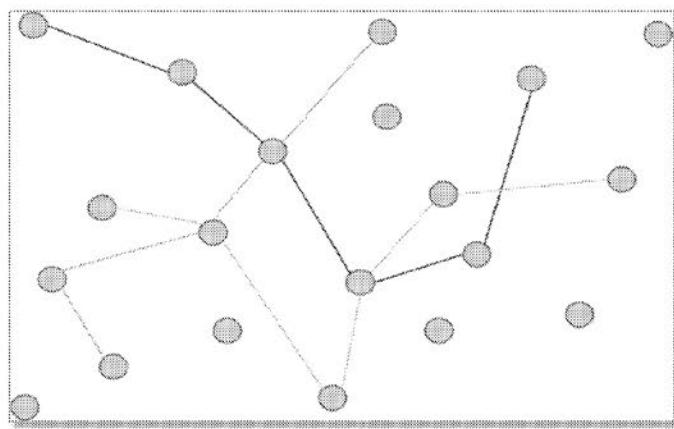
Appendix 1: Paying In Any Currency – How It's Done

- Ripple allows users to create IOU's to each other creating a powerful network for payments
 - My friend trusts me with \$100
 - A merchant trusts my friend with \$100
 - Thus, the merchant now trusts me with \$100 through my friend
- Why this is so powerful
 - Enables payments in any currency or cross currency
 - Allows anyone to act as Paypal does – granting IOU's that enable payments



Appendix 2: Security - Consensus by Nodes

- A Node is a Ripple Client or Server
- Consensus means a majority of selected Nodes must agree on a transaction
 - Prevents “51% attack” vulnerability in BitCoin
 - Prevents double spending issue through consensus
 - Prevents collusion even among untrustworthy nodes
 - Ensures speedy transactions – under 5 seconds



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Appendix 3: Key Regulatory Issues and Tactics

- *Are we subject to prepaid access rules requiring BSA/FinCEN requirements?*
 - We do not maintain the payments system on our servers
 - We will only sell Credits to licensed wholesale Money Services Businesses (MSB's)
- *Although currencies are specifically exempt from securities law, virtual currencies such as BitCoin have not received designation as currencies. As such, are the Credits a security?*
 - Credits will not be sold to users or investors in the Corporation
 - Credits will be given away for free to users
 - We will only sell Credits to licensed wholesale MSB's
- *Are we responsible for illegal uses of the platform?*
 - We will only promote legal uses
 - We will work closely with law enforcement to fight fraud and scams
 - Platform interfaces with the traditional banking system through 'Nexuses', which are licensed MSB's



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